0000121144

ON

The Sunshine City

P.O. BOX 27210
TUCSON, ARIZONA 85726-7210

OFFICE OF
THE
CITY ATTORNEY
(520) 791-4221

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EXCEPTION

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Arizona Corporation Commission
DOCKETED

MAY 29 1998

DOCKETED BY

May 29, 1998

Ray T. Williamson
Acting Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Re: Additional Comments on Staff's Statement of Position Dated May 19, 1998; Docket No. U-RE-00000C-94-0165

Dear Mr. Williamson:

Please accept the following additional comments of the City of Tucson to the Staff's proposal.

The issue of aggregation is of critical concern to the City of Tucson. While Tucson will agree with a phased-in approach to competitive generation based on load size, the City does not agree with artificial barriers to aggregation that require minimum loads (e.g. 20 kW) to build an aggregated base.

It is each aggregator's responsibility to build a load that can be metered, billed and monitored in a manner that allows the aggregator to establish contracts with utilities and powermarketers. Existing utilities have the current capacity to determine distribution load; the aggregator will provide the capacity to measure what is taken off the distribution (utilities DO NOT need additional computer/meter/telecommunications equipment). The feasibility of establishing these contracts will be based on existing infrastructure, cost of new infrastructure and demonstration of ability to provide a predictable load. That is, the decision to aggregate is an economic one and should remain the sole responsibility of the aggregators to determine under which conditions they choose to enter the market place.

Sincerely,

Loretta Humphrey

Loretta Humphrey
Principal Assistant City Attorney

LH:lr

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EXCEPTION

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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED
MAY 29 1998

DOCKETED BY

JIM IRVIN
COMMISSIONER-CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO.: RE-00000C-94-0165 EXCEPTIONS

Office of the City Attorney
P.O. Box 27210
Tucson, Arizona 85726-7210

Pursuant to the Procedural Order of May 13, 1998 and R14-3-110 of the Rules of Practice and Procedure of the Corporation Commission, the City of Tucson submits the following comments and exceptions to the Proposed Opinion and Order in this docket.

- On page 7, line 12 is the assertion that a disadvantage of the Replacement Cost method is that there is no opportunity for a true-up. Tucson believes that this conclusion is incorrect. In his testimony Dr. Eugene Coyle recommended both this method and a true-up. (Recommended "Replacement Cost Valuation" on page 14 of Coyle Direct Testimony (City of Tucson Ex. 1.)):

> Q. Please address the administrative methodologies, the "Net Revenues Lost" and the "Replacement Cost Valuation." Which of these do you favor and why?

A. The "Replacement Cost Valuation" approach, changed in the way I will describe, is clearly superior. The "Net Revenues Lost" has serious problems, both theoretical and practical.

See Also the recommended True-up on page 34 of Coyle Direct (City of Tucson Ex. 1.)

Issue 7. Should there be a true-up mechanism and, if so, how would it operate?

Q. Should there be a true-up mechanism?

A. Yes, there should be a true-up mechanism.

Dr.Coyle's testimony on pp. 34 and 35 goes on to describe the true-up.

- Page 8: Lists the objectives that should be considered in deciding the stranded cost issue. Missing from the list is the idea that rates should not go up as a result of this Decision. There is an objective "D." which states, "Minimize the stranded cost impact on customers remaining on the standard offer." In the discussion of this objective, on page 9, line 22, the Draft asserts: "Accordingly, we will place limitations on stranded cost recovery that will minimize the impact on the standard offer."

The City of Tucson believes that the goal should not be to "minimize the impact on the standard offer". The goal should be to ensure that there is no negative impact on the standard offer. Otherwise rates are going to rise.

- Page 10, lines 12-16. Here the Draft misses the point about California. California was able to award Stranded Costs without raising rates not because of

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P.O. Box 27210
Tucson, Arizona 85726-7210

securitization but because California costs were dropping sharply. There would have been large rate reductions (instead of a freeze) if the Commission/ Legislature had done nothing. See page 30 of Coyle's Testimony (COT Ex. 1) where Moody's Investors Service is quoted from a Special Report.

> Moody's Investors Service recognized the unique situation in California in a Special Report:
>
> We believe that California's plan for recovery of approximately $21 billion in potential stranded assets is not exportable to most other states. In California, the three major investor-owned utilities, rated A1and A2, have similar risk profiles. Their stranded cost exposure originates largely in high-cost, state-mandated purchased power contracts. These contracts start to expire in 1997 and 1998, and the companies' costs will decrease as a result. The California legislation, AB 1890, freezes the companies' rates at current levels, minus a 10% discount for residential and small commercial customers, and allows the companies to use excess cash flow created by the difference between those rates and their lower future costs to pay down a goodly portion of their above market-priced fixed obligations. The situation elsewhere in the country is different. In other states, cost structures may not be trending downward as they are in California. Therefore, there will not be large amounts of excess cash available to pay down stranded investments.[1]

The Hearing Officer's Draft offers no assurance that rates will not rise because of Stranded Costs. In fact, the use of the word "minimize" instead of "eliminate" in discussing the impact on the Standard Offer customers implies that there will be a price rise for small customers.

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[1] Special Report, Moody's Investors Service, February 28, 1997, page 1.

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P.O. Box 27210
Tucson, Arizona 85726-7210

Office of the City Attorney
P.O. Box 27210
Tucson, Arizona 85726-7210

- Page 11 in the discussion of Option 1.: The Hearing Officer's proposal appears to shift costs from those purchasing from competitors onto those customers on the Standard Offer. No date is specified as the moment when Stranded Costs are determined. There is no explanation of how the "proportionate amount" that Standard Offer customers and others must pay is to be determined. The Standard Offer customers pay 100% of generation related Stranded Costs each year while customers purchasing from competitors pay declining amounts -- in Year 2, 80%; year 3, 60%; etc.

There is no explanation of how the Standard Offer is to be calculated and if it will remain constant for a certain number of years. If it remains constant, then each customer on this offer, including new customers, contributes to 100% of the assumed stranded costs. The growth in customers provides additional revenues to the utility, so it appears that more than 100% of a "proportionate share" of stranded costs would be collected from the Standard Offer customers.

Although on page 6 the Draft says it will focus on certain questions, including Question No. 5, "Should there be a limitation on the recovery timeframe for "stranded costs?" this question is not addressed directly. The answer to it is implied in some discussion. But this should be specifically addressed. Finding of Fact No. 33 talks of a "five year transition period" but not specifically a "collection period." For Option 2, the Draft Order specifies that 100% of Stranded Costs will be collected over a ten year period, with no carrying charges on the unamortized balance. (See page 12 of the Draft Opinion and Order)

Regulatory Assets are discussed separately with respect to Option 1.[2] For Regulatory Assets the Draft Order mentions two different periods for collection. One permits an Affected Utility to collect 100% of regulatory assets over its existing amortization period. The second allows collection over ten years, with a full rate of return on, as well as of, for five years, with a declining "return on" for an additional five years. With respect to the Stranded Costs on Regulatory Assets, the Draft Order specifies that the Standard Offer rate would be reduced in the sixth year, to reflect the lower rate of return allowed in that year. Specifically addressing the adjustment of the Standard Offer here implies that it will not be adjusted with respect to generation assets, since such an adjustment was not mentioned in that section of the Draft Order. This too suggests that no rate relief for small customers can be expected until after five years, i.e. beginning in 2004. Jack E. Davis, Executive Vice President of Arizona Public Service has testified that he expects the excess generation capacity in the Western United States is expected to diminish over time, and to be eliminated by 2006. Thus, when possible rate relief for small customers begins to be possible, the favorable

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[2] For the Divestiture/Auction Methodology, "Each generation asset will have to include its portion of the appropriate regulatory assets." Nothing is said about regulatory assets that are not generation related.

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Tucson, Arizona 85726-7210

market conditions begin to evaporate. There may be no gains at all for Standard Offer customers in the end.

- On page 18, with regard to Question No. 8, on lines 18 to 21 the Order asserts: "We have placed a limitation that customers on the standard offer will not receive an increase as a result of stranded costs. Any stranded costs which would result in an increase to the standard offer will have to be deferred to a future period." (Emphasis added.)

The referenced limitation is not discussed elsewhere in the opinion. Moreover, there is no discussion of how a deferral to a future period would work. The idea of a deferral to future period raises an important issue. First, how the Standard Offer is to be determined is not addressed in this Opinion and Order. In Massachusetts, incumbent utilities have set the Standard Offer below the cost of energy, so that competitors cannot succeed in gaining customers from the incumbent utilities. The utilities are willing to set the low price because they are allowed to carry forward to a future period any losses on the standard offer. Thus, the deferral mentioned on page 18 raises the risk that the Affected Utilities will game the Standard Offer. The interaction of the standard offer and the allowance of a deferral must be carefully controlled so that gaming is not possible. Furthermore, it is not clear when deferred amounts would finally be extinguished. Significant questions on this issue also include:

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Will there be a limitation on the years over which amounts can be deferred?

Will a customer leaving the Standard Offer in the future be exempt from the deferral?

This concludes the comments and exceptions of the City of Tucson.

RESPECTFULLY SUBMITTED this 29th day of May l998.

THOMAS J. BERNING
City Attorney

Loretta Humphrey
Principal Assistant City Attorney

Original and 10 copies hand-delivered by E-Z Messenger this 29th day of May, 1998 to:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Office of the City Attorney
P.O. Box 27210
Tucson, Arizona 85726-7210

Office of the City Attorney
P.O. Box 27210
Tucson, Arizona 85726-7210

Copy of the foregoing mailed
this 29th day of May, 1998 to:

Barbara Klemstine
ARIZONA PUBLIC SERVICE CO.
Law Department, Station 9909
P.O. Box 53999
Phoenix, Arizona 85072-3999

Greg Patterson
RUCO
2828 N Central Ave, Suite 1200
Phoenix, Arizona 85004

Michael A. Curtis
MARTINEZ & CURTIS, P.C.
2712 North 7th Street
Phoenix, Arizona 85006
Attorneys for Arizona Municipal Power Users' Association

Walter W. Meek, President
ARIZONA UTILITY INVESTORS ASSOCIATION
2100 N. Central Avenue, Suite 210
Phoenix, Arizona 85004

Rick Gilliam
LAND AND WATER FUND O F THE ROCKIES
2260 Baseline Road, Suite 200
Boulder, Colorado 80302

Charles R. Huggins
ARIZONA STATE AFL-CIO
110 North 5th Avenue
P.O. Box 13488
Phoenix, Arizona 85002

David C. Kennedy
LAW OFFICES OF DAVID C. KENNEDY
100 West Clarendon Avenue, Suite 200
Phoenix, Arizona 85012-3525

Norman J. Furuta
DEPARTMENT OF THE NAVY
900 Commodore Drive, Building 107
P.O. Box 272 (Attn. Code 90C)
San Bruno, California 94066-0720

Thomas C. Horne
Michael S. Dulberg
HORNE, KAPLAN & BISTROW, P.C.
40 North Central Avenue, Suite 2800
Phoenix, Arizona 85004

Barbara S. Bush
COALITION FOR RESPONSIBLE ENERGY EDUCATION
315 West Riviera Drive
Tempe, Arizona 85252

Rick Lavis
ARIZONA COTTON GROWERS ASSOCIATION
4139 East Broadway Road
Phoenix, Arizona 85040

Steve Brittle
DON'T WASTE ARIZONA, INC.
6205 South 12th Street
Phoenix, Arizona 85040

Karen Glennon
19037 N. 44th Avenue
Glendale, Arizona 85308

AJO IMPROVEMENT COMPANY
P.O. Drawer 9
Ajo, Arizona 85321

COLUMBUS ELECTRIC COOPERATIVE, INC.
P.O. Box 631
Deming, New Mexico 88031

CONTINENTAL DIVIDE ELECTRIC COOPERATIVE
P.O. Box 1087
Grants, New Mexico 87020

DIXIE ESCALANTE RURAL ELECTRIC ASSOCIATION
CR Box 95
Beryl, Utah 84714

GARKANE POWER ASSOCIATION, INC.
P.O. Box 790
Richfield, Utah 84701

MOHAVE ELECTRIC COOPERATIVE, INC.
P.O. Box 1045
Bullhead City, Arizona 86430

MORENCI WATER AND ELECTRIC COMPANY
P.O. Box 68
Morenci, Arizona 85540

Stephen Ahearn
ARIZONA DEPT OF COMMERCE
ENERGY OFFICE
3800 North Central Avenue, 12th Floor
Phoenix, Arizona 85012

Betty Pruitt
ARIZONA COMMUNITY ACTION ASSOC.
2627 N. 3rd Street
Phoenix, Arizona 85004

Choi Lee
PHELPS DODGE CORP.
2600 N. Central Avenue
Phoenix, Arizona 85004-3014

Bradley Carroll
TUCSON ELECTRIC POWER CO.
P.O. Box 711
Tucson, Arizona 85702

Creden Huber
SULPHER SPRINGS VALLEY
ELECTRIC COOPERATIVE
P.O. Box 820
Willcox, Arizona 85644

Mick McElrath
CYPRUS CLIMAX METALS CO.
P.O. Box 22015
Tempe, Arizona 85285-2015

Wallace Kolberg
SOUTHWEST GAS CORP.
P.O. Box 98510
Las Vegas, Nevada 89193-8510

A.B. Baardson
NORDIC POWER
4281 N. Summerset
Tucson, Arizona 85715

Michael Rowley
c/o CALPINE POWER SERVICES
50 West San Fernando, Suite 550
San Jose, California 95113

Dan Neidlinger
3020 N. 17th Drive
Phoenix, Arizona 85015

Jessica Youle
PAB300
SALT RIVER PROJECT
P.O. Box 52025
Phoenix, Arizona 85072-2025

Patricia Cooper
AEPCO
P.O. Box 670
Benson, Arizona 85602-0670

Clifford Cauthen
GRAHAM COUNTY ELECTRIC CO-OP
P.O. Drawer B
Pima, Arizona 85543

Marv Athey
TRICO ELECTRIC COOPERATIVE
P.O. Box 35970
Tucson, Arizona 85740

Office of the City Attorney
P.O. Box 27210
Tucson, Arizona 85726-7210

Joe Eichelberger
MAGMA COPPER COMPANY
P.O. Box 37
Superior, Arizona 85273

Louis A. Stahl
STREICH LANG
2 North Central Avenue
Phoenix, Arizona 85004

Wayne Retzlaff
NAVOPACHE ELECTRIC CO-OP INC.
P.O. Box 308
Lakeside, Arizona 85929

Douglas Mitchell
SAN DIEGO GAS AND ELECTRIC CO.
P.O. Box 1831
San Diego, California 92112

Craig Marks
CITIZENS UTILITIES COMPANY
2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012

Sheryl Johnson
TEXAS-NEW MEXICO POWER CO.
4100 International Plaza
Fort Worth, Texas 76109

Steve Kean
ENRON
P.O. Box 1188
Houston, Texas 77251-1188

Ellen Corkhill
AARP
5606 North 17th Street
Phoenix, Arizona 85016

Jack Shilling
DUNCAN VALLEY ELECTRIC COOPERATIVE
P.O. Box 440
Duncan, Arizona 85534

Phyllis Rowe
ARIZONA CONSUMERS COUNCIL
6841 N. 15th Place
Phoenix, Arizona 85014

Nancy Russell
ARIZONA ASSOCIATION OF INDUSTRIES
2025 N. 3rd Street, Suite 175
Phoenix, Arizona 85004

Andrew Gregorich
BHP COPPER
P.O. Box M
San Manuel, Arizona

Barry Huddleston
DESTEC ENERGY
P.O. Box 4411
Houston, Texas 77210-4411

Larry McGraw
USDA-RUS
6266 Weeping Willow
Rio Rancho, New Mexico 87124

Steve Montgomery
JOHNSON CONTROLS
2032 West 4th Street
Tempe, Arizona 85281

Jim Driscoll
ARIZONA CITIZEN ACTION
2430 S. Mill, Suite 237
Tempe, Arizona 85282

Terry Ross
CENTER FOR ENERGY AND
ECONOMIC DEVELOPMENT
7853 E. Arapahoe Court, Suite 2600
Englewood, Colorado 80112

William Baker
ELECTRICAL DISTRICT NO. 6
P.O. Box 16450
Phoenix, Arizona 85011

Ken Saline
K.R. SALINE & ASSOCIATES
160 N. Pasadena
Suite 101
Mesa, AZ 85201-6764

John Jay List
General Counsel
NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORP.
2201 Cooperative Way
Herndon, Virginia 21071

Office of the City Attorney
P.O. Box 27210
Tucson, Arizona 85726-7210

Wallace Tillman
Chief Counsel
NATIONAL RURAL ELECTRIC
COOPERATIVE ASSOCIATION
4301 Wilson Blvd.
Arlington, Virginia 22203-1860

Robert Julian
PPG
1500 Merrell Lane
Belgrade, Montana 59714

C. Webb Crockett
FENNEMORE CRAIG
3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
Attorneys for Asarco, Inc., Cyprus Climax Metals Co.; Enron, Inc. and AAEC

Department of Navy
Naval Facilities Engineering Command
Navy Rate Intervention
901 M Street SE, Building 212
Washington, DC 20374
Attn: Sam DeFrawi

Robert S. Lynch
340 E. Palm Lane, Suite 140
Phoenix, Arizona 85004-4529

Douglas A. Oglesby
Vantus Energy Corporation
353 Sacramento Street, Suite 1900
San Francisco, California 94111

Michael Block
Goldwater Institute
Bank One Center
201 North Central
Concourse Level
Phoenix, Arizona 85004

Stan Barnes
Copper State Consulting Group
100 W Washington Street, Suite 1415
Phoenix, Arizona 85003

Carl Robert Aron
Executive Vice President and COO
Itron, Inc.
2818 N. Sullivan Road\
Spokane, Washington 99216

Douglas Nelson
DOUGLAS C NELSON PC
7000 N. 16th Street, Suite 120-307
Phoenix, Arizona 85020

Lawrence V. Robertson Jr.
MUNGER CHADWICK PLC
333 North Wilmot, Suite 300
Tucson, Arizona 85711-2634
Attorney for PGE Energy

Tom Broderick
6900 East Camelback Rd. # 700
Scottsdale, Arizona 85251

Albert Sterman
ARIZONA CONSUMERS COUNCIL
2849 East 8th Street
Tucson, Arizona 85716

Michael Grant
GALLAGHER & KENNEDY
2600 N. Central Avenue
Phoenix, Arizona 85004
Attorneys for AEPCO

Suzanne Dallimore
Antitrust Unit Chief
Department of Law Building
Attorney General's Office
1275 West Washington Street
Phoenix, Arizona 85007

Lex Smith
Michael Patten
BROWN & BAIN PC
2901 N. Central Avenue
Phoenix, Arizona 85001-0400
Attorneys for Morenci Water & Electric, Ajo Improvement & Phelps Dodge Corp.

Vinnie Hunt
CITY OF TUCSON
Department of Operations
4004 S. Park Avenue, Building #2
Tucson, Arizona 85714

Steve Wheeler
Thomas M. Mumaw
SNELL & WILMER
One Arizona Center
400 E. Van Buren Street
Phoenix, Arizona 85004-0001
Attorneys for APS

Office of the City Attorney
P.O. Box 27210
Tucson, Arizona 85726-7210

Office of the City Attorney
P.O. Box 27210
Tucson, Arizona 85726-7210

Albert Sterman
ARIZONA CONSUMER COUNCIL
2849 E. 8th Street
Tucson, Arizona 85716

William Sullivan
MARTINEZ & CURTIS, P.C.
2716 N. 7th Street,
Phoenix, Arizona 85006
Attorneys for Mohave Electric Cooperative and
Navopache Electric Cooperative

Elizabeth S. Firkins
INTERNATION BROTHERHOODL OF
ELECTRICAL WORKERS, L.U. #1116
750 S. Tucson Blvd.
Tucson, Arizona 85716-5698

Norman J. Furuta
Associate Counsel
Engineering Field Activity West
Naval Facilities Engineering Command
900 Commodore Drive, Bldg. 107
San Bruno, California 94066-5006

Jeff Woner
K.R. Saline & Associates
160 N. Pasadena
Mesa, Arizona 85201

Carl Dabelstein
2211 E. Edna Avenue
Phoenix, Arizona 85022

Larry K. Udall
Arizona Municipal Power Users' Assoc.
2712 N. 7th Street
Phoenix, Arizona 85006-1090

Roderick G. McDougall
City Attorney
Attn: Jesse Sears, Assistant Chief Counsel
200 W Washington Street, Suite 1300
Phoenix, Arizona 85003-1611

William J. Murphy
200 W Washington Street, Suite 1400
Phoenix, Arizona 85003-1611

Russell E. Jones
33 N. Stone Ave., Suite 2100
P.O. Box 2268
Tucson, Arizona 85702
Attorneys for Trico Electric Cooperative, Inc.

Christopher Hitchcock
P.O. Box 87
Bisbee, Arizona 85603-0087
Attorneys for Sulphur Springs Valley
Electric Cooperative, Inc.

Myron L. Scott
1628 E. Southern Avenue, No. 9-328
Tempe, AZ 85282-2179
Attorneys for Arizona for a Better Environment

Andrew Bettwy
Debra Jacobson
SOUTHWEST GAS CORPORATION
5241 Spring Mountain Road
Las Vegas, Nevada 89102

Barbara R. Goldberg
OFFICE OF THE CITY ATTORNEY
3939 Civic Center Blvd.
Scottsdale, Arizona 85251

Terry Ross
Center for Energy & Economic Development
P.O. Box 288
Franktown, Colorado 80116

Peter Glaser
DOHERTY RUMBLE & BUTLER PA
1401 New York Ave., N.W., Suite 1100
Washington, DC 20005

Phyllis Rowe
ARIZONA CONSUMERS COUNCIL
P.O. Box 1288
Phoenix, Arizona 85001

Paul Bullis, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Director Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007